

Franchise Tax Board**ANALYSIS OF AMENDED BILL**

Author: Migden Analyst: John Pavalasky Bill Number: SB 1113
Related Bills: See Legislative History Telephone: 845-4335 Amended Date: June 18, 2008
Attorney: Patrick Kusiak Sponsor: _____

SUBJECT: Authorize Court to Award Attorney's Fees and Non-Statutory Costs, Including Expert Witness Fees

SUMMARY

This bill would authorize a court to include non-statutory costs, including expert witness fees when awarding attorney's fees under the Code of Civil Procedure (CCP).

SUMMARY OF AMENDMENTS

The March 24, 2008, amendments removed all of the bill's provisions, which related to property taxation, and replaced them with the provisions discussed in this analysis. The June 18, 2008, amendments made technical changes.

This is the department's first analysis of the bill.

PURPOSE OF THE BILL

According to the author's office, this bill is intended to return the law regarding expert witness fees and other non-statutory costs to the long-held understanding prior to a recent court decision because these costs are often critical to the outcome of public interest cases.

This is the department's first analysis of the bill.

EFFECTIVE/OPERATIVE DATE

This bill would be effective on January 1, 2009, and apply to lawsuits filed on or after that date.

POSITION

Pending.

Board Position:

_____ S _____ NA _____ NP
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Department Director**Date**

Selvi Stanislaus

6/24/08

ANALYSIS

CASE LAW

Northwest Case

On August 21, 2006, in *Northwest Energetic*,¹ a superior court awarded attorney fees of \$3.5 million against the Franchise Tax Board (FTB) under CCP section 1021.5 and the common fund doctrine.

FTB appealed, arguing that the award of attorney fees should not have been granted on three alternative grounds:

- (1) The court erred by awarding attorney fees under CCP section 1021.5 and the common fund doctrine. Those fees can only be recovered under Revenue and Taxation Code (R&TC) section 19717 (which result in a substantially smaller award).
- (2) Northwest did not meet the requirements of CCP section 1021.5 and the common fund doctrine; and
- (3) The court erred in adjusting the lodestar computation upward.

The appellate court found that:

- (1) R&TC section 19717 was not the only provision by which a party in a tax refund action may recover its attorney fees;
- (2) The FTB failed to establish that the requirements for an award of attorney fees under CCP section 1021.5 were not met; and
- (3) The trial court erred in adjusting the lodestar upwards. The case was remanded back to the trial court to re-determine the amount of fees and costs to be awarded.

The FTB petitioned the California Supreme Court for review, and that petition was denied on June 11, 2008. The case will now be remanded to the trial court for findings consistent with the decision of the Court of Appeal.

Beasley v. Wells Fargo Bank and Olson v. Automobile Club Cases

In 1991, the California Appellate Court held that expert witness fees and other nonrecoverable expenses incurred by counsel may be awarded under CCP section 1021.5.² However, Olson rejected this interpretation and thus overruled Beasley.

In February 2008, the California Supreme Court found that CCP section 1021.5, which authorizes the award of attorney fees, did not authorize the award of expert witness fees.³ The Court noted that the plain language of CCP section 1021.5 authorizes an award of attorneys' fees to a prevailing party and is silent with respect to expert witness fees. The Court further noted that expert witness fees are typically not considered a subset of attorneys' fees, but rather as a distinct and independent subset of the costs of litigation. In addition, the Court emphasized that the Legislature's omission of expert witness fees from the statute was notable in light of the numerous statutes that expressly include language regarding expert witness fees.

¹ *Northwest Energetic Services, LLC v. Franchise Tax Board* (A114805, A115841, and A115950 [Consolidated]).

² *Beasley et. al. v. Wells Fargo Bank* (1991) 235 Cal. App. 3d 1407.

³ *Olson v. Automobile Club of Southern California* (2008) 42 Cal.4th 1142.

CURRENT STATUTORY LAW

Revenue and Taxation Code

R&TC section 19717 provides that certain parties that prevail against FTB in a civil proceeding may be awarded reasonable litigation costs, which is defined by that section to include court costs, expert witness fees, the cost of studies, and attorney fees. To receive attorney fees a prevailing party must meet three requirements: (1) have exhausted all available administrative remedies prior to initiating the lawsuit, (2) have reasonable litigation costs allocable solely to the State of California, and (3) have reasonable litigation costs during the civil proceeding, except for the period in which the prevailing party has unreasonably protracted that proceeding. The hourly rate for attorney fees is capped. The cap is adjusted each calendar year using a statutory cost-of-living rate. A court may award attorney fees above the capped rate when a special factor presents itself. The statutory examples of special factors are: the availability of qualified attorneys for the type of case, the difficulty of the case, and the local availability of tax attorneys. To be considered a prevailing party, the party must substantially prevail on the disputed amount, or substantially prevail on the significant issues in the case. However, if the State of California establishes that its position was substantially justified, then the prevailing party may not recover any litigation costs.⁴ To be substantially justified, the state's position must have a reasonable basis in law and fact. It does not need to be a winning argument.⁵

Code of Civil Procedure

CCP section 1021.5 provides that a prevailing party whose litigation results in the enforcement of an important public interest may be awarded attorney fees. To receive attorney fees, a party must meet three requirements: (1) provide a significant benefit to the general public, (2) have a financial burden that makes the attorney fee award appropriate, and (3) achieve justice the circumstances require that attorney fees be provided in addition to the recovery. A significant benefit may be monetary or non-monetary. It does not need to be a concrete benefit.⁶ The significant benefit requirement is met if the benefit only affects the general public. A financial burden that makes an award appropriate is one where the cost of victory exceeds the party's personal interest so that the cost of the lawsuit is disproportionate to the disputed issue. A court may award less than the full amount of attorney fees when a successful party's financial gain warrants. Public entities may not receive attorney fees in litigation against individuals.⁷ Attorney fees are calculated by determining the lodestar and applying a multiplier. The lodestar is the product of hours the attorney worked times a reasonable hourly rate. The trial court may increase or decrease the lodestar by a multiplier.⁸ For example, if an attorney worked ten hours at a reasonable hourly rate of \$350, then the lodestar is \$3,500. If a multiplier of 2 is applied, the final attorney fees awarded are \$7,000.

⁴ R&TC section 19717(c)(2)(B)(i).

⁵ *McDonnell Douglas Corp. v. Franchise Tax Bd.*, 26 Cal. App. 4th 1789, 1798 (Cal. Ct. App. 1994).

⁶ *Woodland Hills Residents Ass'n v. City Council of L.A.*, 23 Cal. 3d 917, 939 Footnote 12 (Cal. 1979).

⁷ Cal. Code Civ. Proc. section 1021.5.

⁸ *Downey Cares v. Downey Community Development Com.*, 196 Cal. App. 3d 983, 994 (1987).

Unlike R&TC section 19717, CCP section 1021.5 does not require the exhaustion of administrative remedies and allows an award of attorney fees even if the defendant (here FTB) was substantially justified in defending the lawsuit. For example, in *Ventas*⁹ the award under CCP section 1021.5 was 1.5 times the lodestar or about \$225,000, but in that case there had been no exhaustion of administrative remedies and thus would not have been awarded under R&TC section 19717.

The California Constitution requires a state agency to enforce a statute until an appellate court determines it unconstitutional.¹⁰

THIS BILL

This bill would authorize a court to award non-statutory costs, including expert witness fees, in addition to attorneys' fees, under CCP section 1021.5. As a result, FTB could be required to pay expert witness fees and other non-statutory costs in addition to attorneys' fees in the future in connection with suits brought under CCP section 1021.5.

IMPLEMENTATION CONSIDERATIONS

Because the term "non-statutory costs" is undefined, it could be argued to be extremely broad.

PROGRAM BACKGROUND

In 1974, the United States Court of Appeals for the District of Columbia awarded the Wilderness Society, Environmental Defense Fund, and Friends of the Earth attorney fees for serving as a private attorney general.¹¹ The attorney fees were sought for the plaintiff's litigation to prevent construction of an Alaskan pipeline. The Court of Appeals found that the plaintiffs acted as a private attorney general by enforcing public policy and should not have to finance litigation that was for a public benefit. The fee shifting was not intended to be punitive. In 1975, the United States Supreme Court reversed the decision in *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*¹² because the Court of Appeals awarded the attorney fees without a statutory basis and because this award was contrary to "the general 'American rule' that the prevailing party may not recover attorneys' fees as costs or otherwise." The Supreme Court in this case also stated that it was within the authority of Congress to create a private attorney general doctrine.

The Equal Access to Justice Act (EAJA) was enacted by Congress and became effective October 21, 1980.¹³ It has a justification similar to the private attorney general doctrine. The purpose of the EAJA was to reduce the disincentive for certain parties to engage in litigation with the federal government because of the high cost involved in protecting their rights.¹⁴

⁹ *Ventas Finance I, LLC v. Franchise Tax Board*, (A116277, app. pending First District of the California Court of Appeal.)

¹⁰ Cal. Const. Art. III, section 3.5.

¹¹ *Wilderness Soc. v. Morton*, 495 F.2d 1026 (D.C. Cir. 1974).

¹² *Alyeska Pipeline Serv. Co. v. Wilderness Soc'y*, 421 U.S. 240, 241 (1975).

¹³ Oct. 21, 1980, PL 96-481, Title II, section 201 et seq., 94 Stat. 2325 -2330. That federal Act added 5 USC section 504 for administrative adjudications and amended 28 USC section 2412 for judicial proceedings.

¹⁴ Oct. 21, 1980, PL 96-481, Title II, section 202, 94 Stat. 2325.

In 1977, the California Supreme Court created the private attorney general doctrine in *Serrano v. Priest*.¹⁵ The court found in that case that the United States Supreme Court's ruling against a federal private attorney general doctrine did not prevent state courts from creating it as a state-based doctrine. Additionally, that case explained that even though California statutes followed the general American rule regarding attorney fees, the California courts had already established two exceptions "based upon the inherent equitable power of the court." The first exception was the common fund principle: those who benefit from another's litigation that creates a fund should share in the expense that created the fund. The second exception was the substantial benefit rule: non-litigants who benefit from litigation that acts in a representative capacity and creates a substantial benefit for the non-litigants should share in the expense that created the substantial benefit.

In *Serrano v. Priest* the California Supreme Court first applied the private attorney general doctrine. That case determined that the financing system for California schools violated the state constitution's equal protection provisions. The court's rationale for the doctrine was that many citizens have common interests. The benefit to society of these interests is momentous, but not large enough for one private citizen to litigate alone.

The court applied the doctrine to constitutional rights and left the determination of whether it should apply to statutory rights for another case. The California legislature acted immediately to apply the private attorney general doctrine to statutory rights.¹⁶ Effective January 1, 1978, CCP section 1021.5 codified the California Supreme Court's decision.

OTHER STATES' INFORMATION

The laws of *Florida*, *Illinois*, *Massachusetts*, *Michigan*, *Minnesota*, and *New York* were surveyed because their tax laws are similar to California's income tax laws.

None of these states have an Equal Access to Justice Act as broad and encompassing as California's private attorney general doctrine as codified in CCP section 1021.5. *Florida* has a private attorney general provision in Florida Statute section 400.023.

The statute pertains to the rights of those in nursing homes and related health care facilities. Recovery of costs and reasonable attorney fees not to exceed \$25,000 are available to parties who prevail in seeking injunctive relief or an administrative remedy.

Under *Florida* law, a prevailing taxpayer may be awarded attorney fees and litigation costs when the tax agency's position is not substantially justified. Under the Florida Equal Access to Justice Act, a qualifying party may recover attorney fees and litigation costs resulting from adjudicatory proceedings or administrative proceedings. In an action initiated by the state, an award for attorney fees and costs may not exceed \$50,000.

Illinois, *Massachusetts*, and *Minnesota* law have no equivalent mention of attorney fee and litigation cost recovery in the tax code. *Illinois* and *Massachusetts* law does not contain an EAJA type act. *Minnesota* law contains a provision similar to the federal EAJA. It permits a prevailing party in a civil proceeding with the state to recover fees and other expenses if the party shows the state's position was not substantially justified. The act includes attorney fee awards in tax cases.

¹⁵ *Serrano v. Priest*, 20 Cal. 3d 25 (1977).

¹⁶ *County of Inyo v. City of Los Angeles*, 78 Cal. App. 3d 82, 89 (1978).

Michigan law permits a taxpayer to recover actual damages, which include attorney fees, up to \$10,000 when the tax agency intentionally or recklessly ignores a rule, guideline, procedure, or the law. *Michigan* does not have an EAJA-type act.

The *New York* tax statute provides the exclusive remedy for a prevailing party to be awarded litigation costs and attorney fees in connection with the determination, collection, or refund of any tax. *New York* Tax Law section 3030 provides that certain parties that prevail against the Department of Taxation and Finance in a civil proceeding may be awarded reasonable litigation costs.

Reasonable litigation costs include court costs, expert witness fees, the cost of studies, and attorney fees. The hourly rate for attorney fees is capped. The court may adjust the rate upon a determination that there is an increase in the cost of living. The statutory rate is \$75 per hour. A court may award attorney fees above the capped rate when a special factor presents itself. The statutory example of a special factor is the limited availability of qualified attorneys for such proceedings. To be considered a prevailing party, the party must substantially prevail on the disputed amount, or substantially prevail on the significant issues in the case. However, if the tax agency establishes that its position was substantially justified, then the prevailing party may not recover any litigation costs.

New York has an EAJA, but it is not applicable to tax cases because the tax law provides an exclusive remedy.

FISCAL IMPACT

This bill may result in some departmental administrative costs resulting from increased litigation expense awards brought under CCP section 1021.5. The increased amount that may be incurred is speculative because there have been few awards made under CCP section 1021.5.

ECONOMIC IMPACT

State Fiscal Impact Discussion:

This bill could increase state expenditures by specifying that CCP section 1021.5 authorizes a court to award attorney's fees and non-statutory costs, including expert witness fees. As a result, FTB could be required to pay expert witness fees and other nonstatutory costs in addition to attorney's fees in the future in connection with suits brought under CCP section 1021.5.

The amount of this additional expenditure cannot be quantified because it depends on the outcome of pending litigation, the frequency of future relevant litigation, and on the size of future awards, all of which are unknown.

In August 2006, for the first time, a prevailing party in tax refund litigation against the FTB was awarded attorney's fees under CCP section 1021.5. Additional fee awards under CCP section 1021.5 have been awarded in two cases since that time. In these cases, there were no expert witness fees. The amount of future additional costs resulting from by this bill will depend on the following events occurring:

- 1) A taxpayer prevails in a refund suit against FTB;
- 2) The taxpayer seeks and is awarded fees and non-statutory costs under CCP section 1021.5;
- 3) The court determines the taxpayer's action resulted in the enforcement of an important right affecting the public interest;
- 4) Expert witness fees are part of the litigating costs borne by the taxpayer.

Because this proposal only applies to suits filed after January 1, 2009, and there is typically three to four years between the date litigation is filed and the date an award for litigation costs is made, no fiscal impact is expected before the 2012-2013 fiscal year.

ARGUMENTS/POLICY CONCERNS

The California Constitution requires a state agency to enforce a statute without regard to the issue of constitutionality until an appellate court determines the statute unconstitutional.¹⁷ Consequently, FTB must enforce a statutory provision of the R&TC without regard to the constitutionality of that statute, which subjects the state to possible significant awards for costs, including nonstatutory costs and expert witness fees, in addition to attorneys' fees, if this bill is enacted.

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¹⁷ Cal. Const. Art. III section 3.5.